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Office of the Legislative Auditor

State of Montana

Report to the Legislature

April 1990

Performance Audit Report

Withholding Tax Program

Department of Revenue

This report contains recommendations for improvement in the administration of the Withholding Tax program. The recommendations include:

- Improving management controls in the Income and Miscellaneous Tax Division.
- Seeking legislative authority for write-offs of delinquent taxes that cannot be collected.

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PERFORMANCE AUDITS

Performance audits conducted by the Office of the Legislative Auditor are designed to assess state government operations. From the audit work, a determination is made as to whether agencies and programs are accomplishing their purposes, and whether they can do so with greater efficiency and economy. In performing the audit work, the audit staff uses audit standards set forth by the United States General Accounting Office.

Members of the performance audit staff hold degrees in disciplines appropriate to the audit process. Areas of expertise include business and public administration, statistics, economics, computer science, and engineering.

Performance audits are performed at the request of the Legislative Audit Committee which is a bicameral and bipartisan standing committee of the Montana Legislature. The committee consists of four members of the Senate and four members of the House of Representatives.

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April 1990

The Legislative Audit Committee
of the Montana State Legislature:

This is our performance audit of the Withholding Tax program administered by the Department of Revenue.

This report contains recommendations concerning management controls over this program. Areas for legislative consideration are also included. Department responses are contained at the end of the report.

We wish to express our appreciation to the staff of the department for their cooperation and assistance.

Respectfully submitted,

Scott A. Seacat
Legislative Auditor

Office of the Legislative Auditor

Performance Audit

Withholding Tax Program

Department of Revenue

Members of the audit staff involved in this audit were: Jim Nelson, manager; Mary Reynolds, auditor-in-charge; Angie Grove, senior auditor; and C. Susan Jensen, staff auditor.

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Report Summary

Our performance audit concentrated on the Withholding Tax program administered by the Income and Miscellaneous Tax Division, Department of Revenue. Every employer who pays wages for services performed in Montana, or for services performed outside of Montana by an employee who is a Montana resident, must withhold tax. The amount withheld is sent to the Department of Revenue on a periodic basis. The total amount collected for 1988 was approximately $196,534,000.

Introduction

Three sections within the Department of Revenue's Income and Miscellaneous Tax Division are charged with the primary administrative duties of the program. The sections are: 1) Business Tax Section, Audit Bureau; 2) Field Audit Section, Audit Bureau; and 3) Accounts Receivable and Collection Section, Administrative Services Bureau.

The Accounts Receivable and Collection Section is responsible for collecting outstanding taxes, penalties, and interest. Tax accounts are referred to this section after the employers and taxpayers are sent notices by the department. In August 1989, there was approximately $4.6 million in withholding taxes to be collected.

Legislative Clarification for Write-Offs

The Accounts Receivable and Collection Section is writing off delinquent taxes, penalties, and interest which are determined to be uncollectible. The majority of write-offs occurred after implementation of a new delinquent accounts receivable computer system application and development of a new write-off policy for collectors. These changes resulted in approximately $2,031,000 being written off between April 1989 and July 1989 to address the backlog of old and unproductive accounts. Although the write-off amount is uncommonly high for this period, it is reasonable.

Because the Bad Debts Unit and related statutes became the responsibility of the State Auditor's Office January 1, 1990, the division no longer has specific legislative authority to write off

taxes. Section 15-1-206, MCA, still gives the division authority to waive penalties and interest. There is no mention of waiving actual taxes due. We believe the department needs to seek legislative authority to allow write-offs of delinquent taxes that cannot be collected, or transfer all such accounts to the Bad Debts Unit, State Auditor's Office.

Payment Methods

Division staff accept payment for outstanding taxes, penalties, and interest by various methods such as credit cards, installment payments, and deferred payments. The division has developed policies and procedures for collection staff to follow in collecting these payments.

Section 15-30-305, MCA, authorizes the Department of Revenue to make rules as necessary to enforce provisions of the law relating to collection of income taxes. There are no Administrative Rules in place specifying the payment methods. We believe the division should update its Administrative Rules to include criteria for accepting the various methods of payment of taxes, penalties, and interest.

Formal Process for Supervision of Staff Needed

There is limited supervision and review of staff work in the Accounts Receivable and Collection Section. During our review of collection files, we noted several instances where collectors were inconsistent in their procedures. We also found inconsistencies in workload. Some of the administrative staff help in other sections due to lack of work in their areas of the Accounts Receivable and Collection Section while other staff in the same section have more work than they can handle.

We recommend division management establish a formal supervision and review process of staff activities at all levels in the Accounts Receivable and Collection Section.

Adequacy of Management Information

Management information in some areas of the Accounts Receivable and Collection Section is limited. Some reports generated do not provide complete and accurate information on the monitored activity. For example, the dollar amounts attributed to each collector do not accurately reflect actual staff performance. Some reports generated by the system and reports generated by the section supervisor are duplicates. Information obtained from the computer is compiled by the supervisor in a different format on a personal computer.

These problems occurred when the division implemented the new delinquent accounts receivable computer system application. Staff have not, in all cases, made themselves aware of system capabilities or have not made management aware of the type and form of information they need.

We recommend division management determine what management information is needed and available, and eliminate duplicate information.

Goals and Objectives

The division needs to update its goals and objectives. The goals and objectives should take into consideration such things as improvements needed related to staffing and management procedures. Once management has established overall division goals and objectives, each bureau chief and section supervisor should develop more specific goals and objectives applicable to their areas. These goals and objectives should not be based entirely upon dollar amount generated or collected. We found the previous goals only addressed the generation/collection of a specified number of dollars. These goals have created animosity and undue competition among sections, and contributed to duplication of duties between sections.

Income and Miscellaneous Tax Division Staffing Patterns May Be Inadequate

Receivables increased 54 percent between June 1984 and June 1989 in the Accounts Receivable and Collection Section. However, staff levels in that section have remained constant since September 1985. Several other sections in the Income and Miscellaneous Tax Division are operating below allocated staff levels. Division management indicated current budget restraints and high staff turnover have contributed to this problem.

The level of workload affects the number of accounts each collector must address. From February through July 1989 there was an average of 34,000 outstanding accounts. We found all collectors can adequately work only 12 to 15 percent of their assigned accounts.

Due to the increase in receivables and workload, we believe department management should reevaluate staff levels in various sections of the Income and Miscellaneous Tax Division.

Division Communication

Insufficient communication within the division has resulted in limited knowledge among the staff of what duties are performed in other sections or who to contact when there are questions. Clear lines of communication and knowledge of other section's duties would help eliminate duplication of work between sections and assure questions or problems are cleared in a more timely manner. We believe establishing one contact person in each section would decrease inconsistency of information and also encourage section interaction.

Job Descriptions Need Updating

Accurate, complete job descriptions provide staff with clear requirements and expectations essential for adequate performance. Job descriptions also provide supervisors with a useful tool for evaluating staff. We found duties performed in the Accounts Receivable and Collection Section often did not match job descriptions used in 1989.

We recommend division management evaluate current job duties and write job descriptions to reflect duties actually performed.

Relationship of Performance Appraisals to Job Duties

Section supervisors established criteria by which they would appraise staff. In reviewing this criteria, we found staff are not evaluated on many of the functions they perform. The criteria on the appraisals is used to evaluate staff on the number of accounts identified or collected. The current system measures people on the appropriate number of tasks, but the quality of the work is not measured.

We recommend division management revise the performance appraisal system to take into consideration all aspects of a person's duties including the quality of the work performed.

Chapter I
Introduction

Audit Objectives

The Legislative Audit Committee requested a performance audit of the Withholding Tax program administered by the Department of Revenue. The audit addresses issues identified during past financial compliance audits and presents information concerning the operation of the program.

The objectives of this performance audit were:

1. To determine if the Withholding Tax program is operating efficiently and effectively, and as intended.

2. To review the withholding tax rate formula.

3. To review program compliance with all related rules and laws.

4. To determine if controls over the withholding tax computer system application are adequate.

5. To determine if management controls over the program are adequate.

Scope of Audit

The audit was conducted in accordance with government auditing standards for performance audits. The audit focused on sections within the Income and Miscellaneous Tax Division, Department of Revenue. We reviewed operations in the Business Tax Section, the Accounts Receivable and Collection Section, the Compliance Section, and the Field Audit Section. These sections were reviewed due to their role in administering the Withholding Tax program or due to concerns noted during the course of this audit.

We compared written policies and procedures for these sections to actual staff procedures. We reviewed the accuracy of information on the withholding tax computer system application to documentation in the paper files. We compared W-2 information from employers to withholding information filed by employees. We examined forms used throughout the division

for efficiency. We compared duties and functions between sections to note any areas of duplication.

We contacted other states, which have withholding tax programs, to compare operations with Montana's. We noted types and levels of penalties and interest assessed. Various program requirements were examined to note differences.

Criteria used to establish the withholding tax rate formula were obtained and compared to formula results. We documented formula changes and the analysis performed to make the changes.

We also reviewed the adequacy of controls over the withholding tax computer system application. Because the new accounts receivable computer system application is still in the developmental stage, we did not conduct testing of its controls.

Management controls in the sections and division were also examined. We looked at goals and objectives, performance appraisals, staffing needs, staff training, and division communication.

Compliance

As part of the audit we examined compliance with state statutes and administrative rules relating to the Withholding Tax program. Generally we found the program to be in compliance with applicable laws. We found two specific instances of non-compliance. Corrective measures were taken to alleviate the problems noted. These areas are discussed in Chapter III. We also noted areas which need clarification. These issues are discussed in Chapter IV.

Management Memorandums

During the course of this audit, we sent management memorandums to the Income and Miscellaneous Tax Division addressing the following areas:

- -- establishing more complete and accurate records of training received by staff;
- -- correlating the Field Audit Section career ladder to the job descriptions and performance appraisals;
- -- establishing complete and accurate policies and procedures for the Field Audit and Compliance Sections' staff;
- -- developing policies concerning staff use of microcomputers while away from the office;
- -- developing policies concerning the creation and review of microcomputer spreadsheets by section staff;
- -- supervising Compliance Section staff;
- -- eliminating duplicate letters used by the Compliance Section;
- -- updating the Accounts Receivable and Collection Section policy manual to include criteria for issuing warrants of distraint;
- -- eliminating shared passwords used to access the withholding tax computer system application;
- -- updating the Input/Output manual for the withholding tax computer system application; and
- -- creating a disaster recovery plan for the withholding tax computer system application.

We indicated these changes would improve division management controls and help ensure consistency in operations.

Issues for Further Study

A new computer system application for delinquent accounts receivable was implemented in the Spring of 1989. This system tracks over $25 million in outstanding tax accounts. During our audit, the application was being refined and updated to reflect changes or needed corrections. Because of this, and additional program changes, we did not review the general and application computer controls of the application. We believe this testing should be performed when the system is completed.

We identified several issues related to the Cashiering Section in the Centralized Services Division. Our concerns did not directly impact the scope of this audit so we did not conduct testing in this section. The issues include timeliness of processing pay-

ments, coordination with other sections, and reconciliation of information between various computer system applications. These issues are being addressed in the financial compliance audit of the department.

Chapter II
Background

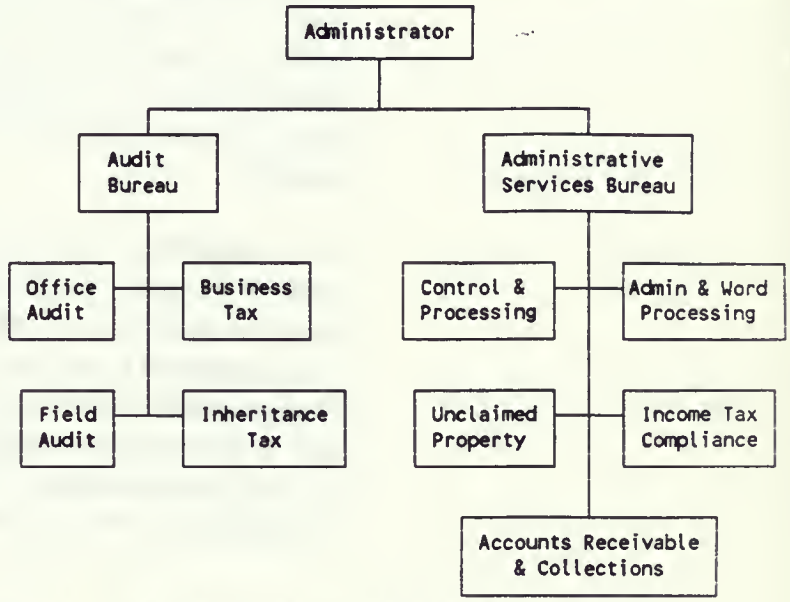
Introduction

Withholding tax is deducted from an employee's wages by an employer for payment of the employee's individual income taxes. Tax money withheld belongs to the employee and is held in trust by the employer until paid to the state. The amount withheld is sent to the Department of Revenue on a periodic basis. The time period depends on the total amount owed by the employer.

The Withholding Tax program is administered by the Department of Revenue. Three sections are charged with the primary administrative duties. The sections are within the Income and Miscellaneous Tax Division and include: 1) Business Tax Section, Audit Bureau; 2) Field Audit Section, Audit Bureau; and 3) Accounts Receivable and Collection Section, Administrative Services Bureau. The following chart details the organization of the division.

Table 1

Income and Miscellaneous Tax Division



Source: Compiled by the Office of the Legislative Auditor from Department of Revenue records

Business Tax Section

Six people in the Business Tax Section are directly responsible for administering the Withholding Tax program. The major duties include: registering employers and giving them a state identification number; ensuring filing information is correctly input to the withholding computer system application; assessing penalties and interest for late filings or payments; determining if penalties or interest should be waived; answering employer questions; refunding any overpayment if needed; and reconciling information submitted at year end to information submitted during the year. The section employees are cross-trained for the various jobs they perform in the section.

Packets are sent out each year containing the forms needed to declare the amount of tax withheld and paid to the department. Information concerning state statutes is also included in the packets.

Two section employees visit employers and inform them of withholding tax statutes, how to complete tax forms, how to calculate the amount to withhold, and how to establish a system to account for the withholding. They also review current records to determine why the employer might be having problems meeting withholding submittal dates.

The employees also conduct small business clinics throughout the state in conjunction with the Department of Labor and Industry and the Internal Revenue Service. These people present information to employers concerning state statutes pertaining to withholding, and instructions on how to prepare the necessary forms. Eight clinics were held in 1989.

Field Audit Section

Field Audit Section personnel conduct audits of employers' and taxpayers' records to determine if they are in compliance with applicable state laws and rules. Seven Department of Revenue employees in Helena and three employees in Billings conduct field audits. Withholding is one of fourteen taxes audited by the unit. Other taxes audited include: individual income tax; accommodations tax; motor fuels tax; cigarette tax; and freight line tax. Both in-state and out-of-state employers are audited.

The section uses three main sources to identify potential withholding audits: 1) a computer generated match of Unemployment Insurance and withholding tax records; 2) income tax returns identified by other division personnel; and 3) withholding and business tax operation referrals, individual returns, and other research. There are about 900 total audits (all types of taxes) in progress at any one time. Fifty-one withholding tax audits were completed in fiscal year 1988-89.

Chapter II
Background

Accounts Receivable and Collection Section

The Accounts Receivable and Collection Section is responsible for collecting outstanding taxes, penalties, and interest. Tax accounts are referred to this section when the employers and taxpayers are sent notices by the department. Thirteen of the fifteen section employees are primarily responsible for collecting and tracking the outstanding accounts. In August 1989, there was approximately $4.6 million in withholding taxes to be collected. This section also collects outstanding accounts for accommodations, income, and dangerous drug taxes. The Section collected approximately $4.8 million in fiscal year 1988-89 for the four taxes.

Nine collectors concentrate on collecting delinquent accounts. They can collect taxes through garnisheed wages, property seizures, and liens against the employer. As a last resort, the accounts may be written off or sent to the Bad Debts Unit, State Auditor's Office. The Accounts Receivable and Collection Section has established guidelines for their collection procedures.

Four accounts receivable clerks are responsible for updating and tracking the division's accounts receivable. While collectors actively pursue employers through the above mentioned methods, accounts receivable personnel concentrate on making changes in account information. This includes updating addresses, interest and penalties owed, and adding additional accounts.

Information From Other States

We sent questionnaires to 43 other states which we believed had a withholding tax program. Of the 42 states which responded, 39 indicated they have a withholding tax program. Our review of the questionnaires indicated most of the programs are similar to Montana's. Most states have employers file quarterly and submit summary information with employees' W-2 forms at the end of the year. Montana's late pay and late file interest rate and penalty is similar to other states. Unlike Montana, the majority of states do not allow partial payments of withheld income taxes, interest and penalties. The collection methods for

employers not submitting withheld taxes or not paying penalties and interest were similar for all states, including Montana. For additional information gathered from other states, see Appendix A.

Chapter III
Withholding Tax Program

Introduction

Every employer who pays wages for services performed in Montana, or for services performed outside of Montana by an employee who is a Montana resident, must withhold tax. The two exceptions are: 1) North Dakota residents working in Montana who have certification of North Dakota residency filed with the Department of Revenue; and 2) Indians residing and working on a reservation and who are enrolled in a recognized Indian tribe. The amount withheld from each employee depends on: 1) gross pay; 2) length of payroll period; and 3) number of withholding allowances claimed by the employee.

Withholding Rate Formula Meets Criteria

A new formula to calculate the amount of money employers should withhold from employees' wages was implemented in January 1987. The previous formula was last updated in 1983. The 1983 formula was a complicated computation using ten different rates applied to various levels of income. The department made several policy decisions when updating the formula to address the concern that lower income brackets did not have enough tax withheld. Department officials also preferred a simple formula comparable to the federal formula and one based only on wage income. The department researched the impact of these decisions on various income groups. They compared the new and old formulae for each income bracket.

The new formula has only four rates applied to different levels of income. The calculation is a two step process. First, net taxable earnings are computed. Second, the actual amount of money to be withheld is determined. This formula can be adjusted to reflect the number of pay periods for each employee. For example, a person with monthly pay periods will have more withheld each paycheck than a person with bi-weekly pay periods. During our review of information from other states, we noted this type of formula is comparable with their formulae.

In examining the intent of the formula and its effect, we reviewed the number of refunds versus the number of payments for individual income tax returns. We found the number of individuals owing more money when they file at year end has decreased by 11,020 since implementation of the formula. The total number of individuals receiving tax refunds has increased by 8,621. The following chart illustrates the changes in the number of refunds and payments in the past three tax years.

Table 2

Number of Individual Income Tax Refunds and Payments (Unaudited)
Tax Years 1986, 1987 and 1988

YEAR	REFUNDS	CUMULATIVE DIFFERENCE	PAYMENTS	CUMULATIVE DIFFERENCE
1986	177,841		138,472	
1987*	179,890	2,049	138,298	(174)
1988	186,462	8,621	127,452	(11,020)

* First year new formula was in effect

Source: Compiled by the Office of the Legislative Auditor from the Department of Revenue records

Based on this information, and the analysis done by the department, it appears the new withholding rate formula meets established criteria by withholding adequate amounts from lower income brackets.

W-4 Allowance Determination is Reasonable

For an employer to determine the amount to be withheld, each employee must complete a federal W-4 form. One form is used for both Federal and state determinations. If an employee claims exempt status from Montana withholding, or claims more than ten allowances on his/her W-4 form, the employer must notify the Department of Revenue. A Business Tax Section employee reviews these situations. A letter is sent to the employer and employee claiming "exempt" explaining that, although the federal government allows exempt status, Montana

law does not. Employees claiming more than ten allowances are sent a questionnaire to help verify the allowances. Upon return of the questionnaire, a section employee determines the number of exemptions for which the person is entitled. The person is then notified of the results. We found the policies and procedures for determining appropriateness of the number of W-4 allowances are reasonable and are followed.

Employer Filings

A person or company deducting Montana withholding tax from an employee's wages must obtain a Montana withholding identification number. The Business Tax Section issues numbers to employers. Upon issuance of the number, and each year thereafter, the employer is sent forms which normally are filed quarterly and at the end of the calendar year.

Employers owing less than $300,000 a year for withholding taxes are required to submit their collections four times a year. One month after the end of each quarter the employer submits the proper form and amount withheld for that quarter. If an employer owes less than $10 in a quarter, the employer is not required to submit the form or amount collected for withheld taxes. Taxes remitted are taken to the Treasury Bureau, Department of Administration, for deposit in the state bank account. In calendar year 1988 22,570 employers, excluding accelerated filers, paid $124,492,558 in withholding tax.

Accelerated Filings

Employers who paid withholding taxes of more than $300,000 in the previous year are required to submit withholding tax payments each week during which wages are paid in the current year. These employers are called accelerated filers. Eighty-four accelerated filers paid $72,041,875 in withholding tax in calendar year 1988. This represents approximately 37 percent of paid withholding tax. The following chart shows the total number of employers filing in 1988 and the amount paid.

Table 3

Withholding Tax Paid In 1988 (Unaudited)

	Employers		Amount Paid	
	22,570	99.6%	$124,492,558	63%
(Accelerated)	84	.4%	$ 72,041,875	37%
Total	22,654	100.0%	$196,534,433	100%

Source: Compiled by the Office of the Legislative Auditor from Department of Revenue records

$300,000 Limit is Reasonable

We reviewed the $300,000 cut-off for accelerated filers to determine if the limit is reasonable. We found changing the limit would not be cost beneficial. Lowering the cut-off to $250,000 would increase workload by 17 percent but only increase the amount paid to the state by 4 percent. The discrepancy between workload and increase in payments becomes larger when the limit is lowered further. Increasing the cut-off to more than $300,000 would not be cost beneficial since the workload would not decrease in proportion to the decrease in revenue.

Penalties and Interest

If a withholding tax payment is not made or is late (the postmark date is considered the date of filing), penalty and interest are assessed. Penalties and interest for failure to pay or for submitting late payments are:

1. For failure to pay withholding tax on or before due date (late pay penalty) without purposely or knowingly violating the requirements of state statutes - 10 percent of the tax due, but not less than $5, plus interest accruing at 9 percent per annum on the tax;

2. For failure to file return of withholding tax on or before due date (late file penalty) without purposely or knowingly violating the requirements of state statutes - 5 percent of the tax due, but not less than $5, plus interest accruing at 9 percent per annum on the tax; and

3. For failure to file return or pay tax (habitual delinquent penalty) by purposely or knowingly violating the requirements of state statutes - 25 percent of tax due, but not less than $25, and interest at 1 percent for each month or fraction of a month during which the tax remains unpaid.

The penalty for not filing W-2 forms at year-end is $5 for each W-2, with a minimum penalty of $50.

Business Tax Section personnel input information to the computer application indicating whether the employer should be charged late file, late pay, or habitual offender interest and penalties. The application calculates the total dollar amount owed and transfers the account to collectors in the Accounts Receivable and Collection Section. A letter is sent to the employer stating how much is owed for taxes (if applicable), interest, and penalties. If the amount owed is not paid in 30 days, another notice is sent to the employer.

Unpaid accounts are first pursued by phone collectors who contact the employer or taxpayer by phone and/or letter. If this is unsuccessful, the account is referred to legal collectors who can use legal means, such as warrants of distraint, liens, etc., to collect payments.

Remind Staff of Habitual Offender Rates

Our review of penalty and interest assessments indicated the correct rates are usually used. We did find one employer, of the 146 tested, was not charged habitual offender rates. The employer had filed late three times in twelve quarters, which is the criteria (45.16.105(2)(b), ARM) followed by section personnel. Upon being informed of our finding, section management issued a memo of procedure to all section staff reminding them how to determine if an employer is an habitual offender.

Correct Computer Program for Partial Payments

We also found the withholding tax computer system application did not charge the proper amount for penalties on partial payments of taxes. For one employer the computer program assessed the late pay penalty on the entire tax due for the quarter and not just the unpaid portion as required by state statute (section 15-30-321, MCA). We could not determine the overall dollar effect of the problem since we only had one such instance in our sample of 146 employers. Section management notified the computer programmer and the problem was corrected.

Procedures for Determination of Waivers are Adequate

If reasonable cause is shown, an employer can have late file and pay penalties waived. Interest less than $100 can also be waived. The waiver must be requested in writing, and will only be considered after the taxes and interest are paid. (If any interest is waived, the amount is refunded to the employer or applied to the tax payment for another quarter.) If an employer is late for the first time in twelve quarters, the penalties are automatically waived upon written request. Other requests for waivers must show reasonable cause for the delay in filing and/or payment. Business Tax Section personnel determine if there is justification for a waiver.

From April 1989 to December 16, 1989, approximately 6 percent (1,259) of the employers requested 1,294 waivers. The following chart shows the disposition of requested waivers.

Table 4

Disposition of Waivers
(April 1989 to December 16, 1989)

Action Taken	Number
Waiver Granted	818
Waiver Denied	282
Waiver Granted of Some Amounts Owed	11
No Action At Time of Audit	111
Penalties Assessed in Error so Deleted	25
Other	47
Total	1,294

Source: Compiled by the Office of the Legislative Auditor from Department of Revenue records

Thirty-five employers with denied waivers requested their cases be reconsidered or they requested an administrative hearing. The following table shows the outcome of the reconsideration or hearing.

Table 5

Outcome of Reconsideration
(April 1989 to December 16, 1989)

Action Taken	Number
Waiver Granted after Additional Information Furnished	17
Waiver Denied	3
No Action at Time of Audit	11
Other	4
Total	35

Source: Compiled by the Office of the Legislative Auditor from Department of Revenue records

We reviewed the procedures for evaluating waiver requests. We found the procedures allow the staff to adequately determine if a waiver should be granted or denied.

Reconciliation of Year-End Information is Appropriate

At calendar year-end, each employer is required to submit a form summarizing payments for the year and a W-2 form for each employee. The total dollar amount indicated as withheld for Montana withholding tax on the W-2 form(s) should equal the amount paid and recorded on the forms submitted by the employer throughout the year. Differences between the amount shown withheld per the W-2(s) and the amount actually paid by the employer are resolved by Business Tax Section personnel. If there is an underpayment, a notice stating more money is due is sent to the employer. Payroll records, W-4 forms, time sheets, etc., are requested so section staff can reconcile the difference if there is an overpayment.

One hundred nineteen employers submitted their 1988 W-2 information to the department on magnetic tape. The W-2 information on the magnetic tape is summed by a computer system application. The total is compared to the amount submitted during the year. The comparison and resolution of differences is conducted in the same manner as used for paper W-2s.

Our review of the division's written policies and procedures concerning the reconciliation process showed the procedures are followed. The policies and procedures ensure the amount paid throughout the year equals the amount reported as withheld on the employees' W-2 forms.

Delinquent Taxpayer Listing Used to Request Taxes

The withholding tax computer system application produces a report listing all employers having unresolved errors in their filings for the year. Errors include such things as a quarterly form which was not filed, missing year end information, year end information which does not reconcile with the amount paid, etc. After the year-end information is input to the computer system application, the section supervisor requests the report and section staff determine what is needed to resolve the errors. Resolution includes making the final balance zero when no

wages were paid so no withholding was due; sending a notice to the employer when penalties need to be paid; or assessing taxes and penalties which are owed. In some cases staff find the taxpayer no longer has employees so the withholding account can be cancelled.

During our review, the section supervisor had not yet requested the 1989 delinquent taxpayer report. We did review the results of the 1988 report. We found the policies and procedures are followed and provide correct resolution of errors. We did note a problem with the assessment of taxes owed. This is discussed below.

Rates for Assessments of Unpaid Taxes Too High

Employers who do not file and do not pay withholding taxes for any quarter(s) will be assessed taxes owed based upon past gross wage information. Business Tax Section personnel assess taxes due for the current year. Staff review prior years to determine if the employer has a history of filing and paying withholding. If a filing history is present, section personnel will obtain gross wage information for the current year from Unemployment Insurance Division, Department of Labor and Industry records. A notice is sent to the employer indicating the estimated amount of withholding taxes due is eight percent of gross wages. Field Audit Section personnel estimate withholding taxes that were not paid in past years. They use an assessment rate of three to five percent of gross wages if no filing history is available.

Some bureau personnel thought the eight percent assessment of taxes due in the current year is used to encourage the taxpayer to file and pay the actual withholding taxes due. In sixteen of the twenty files we reviewed the employer had not paid the assessed taxes at the time of review. The number of unpaid quarters ranged from one quarter in 1988 to many quarters over a period of years. The eight percent assessment is not encouraging employers to file and pay their withholding taxes.

We also found some employers are paying the assessed tax instead of determining what they actually owe and submitting

supporting documentation to the department. We examined previous withholding taxes paid by the employers in our sample and found in the past they paid one to four percent of gross wages. This seems to indicate a more reasonable assessment rate for taxes owed is in the range of one to four percent.

Sections within the division should be consistent in the assessment rate used to determine withholding taxes due. Employers are not treated fairly and equitably if two sections are using different rates for calculating withholding taxes not paid. We believe a lower assessment rate would be more equitable since it would more accurately reflect what the employer actually owes.

Upon notification of our concern, department officials lowered the assessment rate to four percent. This rate will be applied if there is no filing history indicating a higher or lower rate should be used.

Recommendation #1

We recommend division management establish an assessment rate which is consistent between sections and which more accurately reflects the amount owed.

Cancelling an Account

If an employer goes out of business, the employer's withholding file is examined for unpaid taxes, penalties, and interest. An additional check is made of Unemployment Insurance (UI) information to determine if the employer paid UI taxes on wages throughout the year but not withholding tax. If UI taxes were paid but no withholding taxes were paid, Business Tax Section personnel try to resolve any inconsistencies. The information could also be referred to the Field Audit Section for review. If no UI taxes were paid, the withholding tax account is cancelled.

Computer System Application Matches Not Being Used by Business Tax

Business Tax Section staff have access to information on the computer system application used for Unemployment Insurance at the Department of Labor and Industry. Section personnel can access the information to determine the amount of wages, if any, the employer paid in a specified time period. After year end information is reconciled, the Business Tax Section supervisor can request a report comparing amount of wages reported to Unemployment Insurance and wages reported to the Department of Revenue. If wage amounts do not match, the employer is listed on the report. Employers on the report are referred to the Field Audit Section if more than $10,000 in wages were paid during the year. Business Tax Section tries to resolve the differences if the wages are under $10,000.

Due to staffing problems the match made with 1986 and 1987 information was not reviewed by Business Tax Section personnel. Therefore, potential employers who paid less than $10,000 in wages and did not file withholding tax, did not withhold enough tax, or cancelled their withholding account were not identified. The 1988 match had not been run at the time of our audit since the W-2 reconciliation had not yet been completed.

Controls Over the Withholding Tax Computer System Application Are Adequate

All the information concerning withholding tax reported and/or paid by employers is entered on a new computer system application processed on the state's mainframe computer. Some of the information is input by data entry operators in the Data Processing Division, Department of Revenue. They input the information submitted by those employers who used the proper form and paid the total withholding taxes due. Payments received without the form, or forms received by the department without any payments attached, or with payments due, are primarily input by Business Tax Section personnel. We reviewed the controls over the input of information and found information entered on the application is correct and complete.

After the information is input, the computer system application processes the data. If there are any errors a message is printed on a report. Errors include such things as: the employer was not found because the federal identification number did not match one on the system; the filing was late; an address change was made; the total paid is in error because the amount paid did not equal the amount reported as withheld; and state tax withheld is in error because the employer did not owe any money so the amount input was zero. The reports are reviewed by Business Tax Section personnel and errors are corrected directly on the computer system application. We found errors are appropriately reported and corrected.

The computer system application also calculates penalties and interest due. The processing error we found concerning computation of penalties for partial payments of taxes (discussed on page 16) does not occur often so it was overlooked by the department during the initial testing of the application.

We found all output from the computer system is delivered directly to Business Tax Section personnel. Since most of the information is confidential this is appropriate.

Overall, we believe the application controls over the withholding tax computer system application ensure information entered on the application is complete and accurate, errors are correctly resolved, and output is distributed to the appropriate personnel.

Chapter IV
Issues Requiring Clarification

Introduction

Our review of the Withholding Tax program indicates defined legislative intent is met through the various steps used by the department to administer the program. The department adequately processes and accounts for the taxes withheld from employee's wages. The department also collects delinquent taxes and identifies non-complying employers. Tax packets are sent to employers and department staff work with employers to answer their questions. We also found tax information is maintained in a confidential manner.

We did note some policies and procedures followed by the department which need clarification. These issues are discussed in the following sections.

Legislative Clarification for Write-Offs

The Accounts Receivable and Collection Section writes off delinquent taxes, penalties, and interest which are determined to be uncollectible. The majority of write-offs occurred after implementation of a new computer system application for delinquent accounts receivable and development of a new write-off policy for collectors. Prior to the new computer application, there was no efficient way to identify old and unproductive accounts so a limited number were written off or transferred to the Bad Debts Unit. The new application provides staff with an aging of accounts and the status of all accounts, i.e, if monthly payments are received, how many letters and bills have been sent, the amount of the liens outstanding, etc. These changes resulted in approximately $2,031,000 being written off between April 1989 and July 1989 to address the backlog of old and unproductive accounts. Consequently, although the write-off amount is uncommonly high for this period, we believe it is reasonable.

The new write-off policy which staff follows provides clear, reasonable guidelines for writing off accounts. For example, if the taxpayer has died and there are no assets or estate available, it is not reasonable for the collector to pursue the account.

There are also different responsibilities based on the level of the staff member. For example, phone collectors can only approve write-off amounts up to $50 while the section supervisor can approve amounts up to $5,000. Procedures are in place to return the amount written off to the accounts receivable computer system application if further information becomes available.

We found the division no longer has specific legislative authority to write off taxes. Section 15-1-206, MCA, gives authority to waive penalties and interest. There is no mention of waiving actual taxes due. The legislature has outlined procedures for writing off outstanding accounts but these are directed to the Bad Debts Unit which transferred to the State Auditor's Office January 1, 1990.

Recommendation #2

We recommend the department:

A. Seek legislative authority to allow write-offs of delinquent taxes that cannot be collected; or

B. Transfer all such accounts to the Bad Debts Unit, State Auditor's Office.

Payment Methods

Division staff accept payment for outstanding taxes, penalties, and interest by various methods such as credit cards, installment payments, and deferred payments. The division has developed policies and procedures for collection staff to follow in collecting these payments. There are specific guidelines for each level of staff to follow. The new delinquent accounts receivable computer system application allows the division to track this activity more closely.

Current statutes are not specific as to methods for payment of taxes, penalties, and interest. There are no Administrative Rules in place specifying the various methods. Section 15-30-305, MCA, authorizes the Department of Revenue to make rules as necessary to enforce provisions of the law relating to collection of income taxes. If the department continues to accept various methods for payment of taxes, penalties, and interest, it should adopt rules setting forth criteria to be followed to ensure all taxpayers are treated uniformly.

Recommendation #3

We recommend division management update their Administrative Rules to include criteria for accepting the various methods for payment of taxes, penalties, and interest.

Chapter V
Management Controls

Introduction

Managing is the process where people and resources are organized and coordinated in order to accomplish predetermined objectives. During our review of the Withholding Tax program, we noted overall management controls could be improved in the various sections and the division. General areas include planning, organizing, directing, and controlling of staff.

During our audit we informed division management of our findings and recommendations. Division management agreed with our findings and started procedures for implementing the recommendations. The following areas discuss our findings pertaining to both the division and specific sections within the division.

Section Management Controls

In certain sections we noted limited supervision and review of staff and a need for more adequate management information.

Formal Process for Supervision of Staff Needed

We found there is limited supervision and review of staff work in the Accounts Receivable and Collection Section. Staff interviews indicated there is minimal supervision, on-the-job training, and a high level of frustration with the supervision received.

During our review of collection files, we noted several instances where collectors were not consistent in their procedures. Some collectors use the Collection Information Statement, which is a form to outline assets and financial information of taxpayers, while others do not use it. Some collectors issue notices for payments even though taxpayers make regular payments. Other collectors do not send notices as long as payments are regularly received.

Additional areas illustrate a lack of supervision. We found some of the administrative staff help in other sections due to lack of work in their areas of the Accounts Receivable and Collection

Section. Other staff in the same section have more work than they can handle in the normal work week. There had been no performance appraisals of staff for a number of years. Also, we found there were no formal assessments of training and staff indicated they needed training in specific areas.

Lack of review may have resulted in loss of revenue to the state. As of August 1989, there was approximately $36,000 in outstanding accounts which were assigned to the supervisor and had not been addressed. Some of these accounts were dated January 1989 and needed supervisor approval for further action. Division management indicated untimely action can result in limited collection of outstanding revenues since the older the account is, the harder it is to collect.

Proper supervision may have been hindered by excessive turnover of division management. In the two years ending December 1988, the division changed administrators three times. This has contributed to inconsistent supervision and review of activities at the supervisor and staff level. The supervision procedures used by the section supervisor are not reviewed and there is no active appraisal of his performance. Division management indicated changes have been made so there is more supervision of all staff levels.

Regular review of staff activities helps ensure consistent procedures, better work habits, and timely performance of duties. Active supervision also gives division management the opportunity to obtain staff input on section operations.

Recommendation #4

We recommend division management establish a formal supervision and review process of staff activities at all levels in the Accounts Receivable and Collection Section.

Adequacy of Management Information

Management information for the Accounts Receivable and Collection Section is adequate in some areas and limited in others. There are several reports from the new computer system application which provide useful information, such as the Account Aging Report and the Account Status Report. These reports show the age of outstanding accounts (30 days, etc.) and the status of all the accounts (bankruptcy, bill monthly, etc.). However, for other areas, such as the number of accounts transferred to legal collectors, the amount written off by each staff member, etc., there is little information available.

Some reports generated do not provide complete and accurate information on the monitored activity. For example, reports which show dollar amounts collected by each collector include all accounts assigned to that collector. Some of these assigned accounts are cleared, through payment or change in status, without collector involvement. Therefore, the dollar amount attributed to each collector as collected does not accurately reflect actual staff performance. Collectors can only adequately address 12 to 15 percent of the assigned accounts.

Some reports generated by the system and reports generated by the section supervisor are duplicates. Information obtained from the computer is compiled by the supervisor in a different format on a personal computer. This is inefficient use of staff time and resources since the data is input twice.

These problems occurred when the new computer system application was implemented. The application generates reports to track activities and provides new information. Staff have not, in all cases, made themselves aware of system capabilities or have not made management aware of the type and form of information they need. Management should determine what information is required and the most useful format for staff performing section activities. Completion of this evaluation will assist division management in proper use of resources and should eliminate duplicate information.

Recommendation #5

We recommend division management:

A. Determine what management information is needed and available; and

B. Eliminate duplicate information.

Division Controls

The following areas discuss our concerns with management controls in the division. If the following recommendations are implemented, management of the Income and Miscellaneous Tax Division could be more efficient and effective.

Goals and Objectives Could Be Expanded

We requested copies of section goals and objectives during our review of four sections in the Income and Miscellaneous Tax Division. Three of the four section supervisors stated the goals and objectives developed for the Office of Budget and Program Planning for the biennium ending 1988-89 were their section goals and objectives. The fourth section supervisor said there were no goals and objectives covering recent changes in that section.

Upon review of the fiscal year goals and objectives, it appears many of them have already been accomplished. Also, most of the goals and objectives are quantitative - workload, dollars collected, etc. They do not take into consideration such things as improvements needed related to staffing or management procedures. Updated goals and objectives for the division need to be developed. These goals and objectives should consider such things as staffing needs (training, performance appraisals, etc.), and management procedures (increased and better communication between sections and staff, the role of the various sections in the overall operation of the division, etc.).

Once management has established overall division goals and objectives, each bureau chief and section supervisor should develop more specific goals and objectives applicable to their areas. These goals and objectives should not be based entirely upon dollar amount generated or collected. We found setting goals for the generation/collection of a specified number of dollars has created animosity and undue competition among sections, and contributed to duplication of duties between sections. For example, Compliance Section staff are locating taxpayers and negotiating payments of taxes. Compliance Section staff are only supposed to locate taxpayers and assess the taxes. Accounts Receivable and Collection Section staff are responsible for collecting the amounts assessed. Compliance Section staff are negotiating payments so the section can meet its goal of identifying/collecting a specified dollar amount.

Goals and objectives should include such things as the direction in which the chiefs and supervisors would like to see their bureaus and sections headed. Qualitative items, such as communication between sections, training and performance appraisals, could be considered.

The actual extent of accomplishment of goals and objectives should also be determined. The purpose of establishing goals and objectives is to provide direction and it cannot be known if that direction is correct or being achieved if the goals and objectives are not reviewed.

In response to our concern, division management indicated updated goals and objectives would be in place by early 1990.

Recommendation #6

We recommend division management establish goals and objectives for the division, bureaus, and sections, and periodically review the goals and objectives to determine if they are being accomplished.

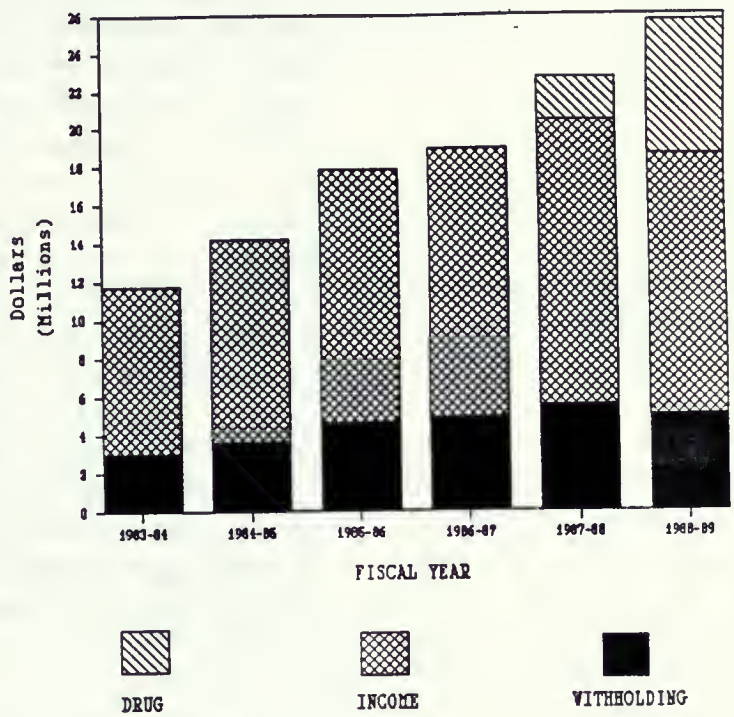
Income and Miscellaneous Tax Division Staffing Patterns May Be Inadequate

We found several sections in the Income and Miscellaneous Tax Division are operating below their allocated staff levels. Division management indicated current budget restraints and high staff turnover contributed to this problem. Some sections have loaned staff to other sections for performance of necessary duties. For example, Accounts Receivable and Collection Section staff have assisted the Control and Processing Section in sorting mail and files. This could inhibit the workflow in the Accounts Receivable and Collection Section.

In reviewing the Accounts Receivable and Collection Section, we found there were nine collectors - five phone collectors and four legal collectors. Outstanding tax receivables for this section increased from approximately $11,741,000 in June 1984 to approximately $25,691,000 in June 1989. This is a 54 percent increase. The following figure illustrates the increases in the three major taxes included in the accounts receivable - withholding tax, income tax, and dangerous drug tax. The accounts receivable for accommodations tax was only 0.16 percent of the total receivables in June 1989.

Figure 1

Major Taxes Included in Receivables (Unaudited)
Fiscal Years 1983-84 through 1988-89



Source: Compiled by the Office of the Legislative Auditor from Department of Revenue records

The increase in receivables has not been accompanied by an increase in staff levels. Staff levels in the Accounts Receivable and Collection Section have been constant since September 1985. Annual collections increased 40 percent, from approximately $2,970,000 (25.3 percent of the outstanding accounts) in fiscal year 1983-84 to approximately $4,967,000 (19.3 percent of the outstanding accounts) in fiscal year 1988-89.

The level of workload has also effected the number of accounts each collector must address. From February through July 1989 there was an average of 34,000 outstanding accounts. The

number of accounts does not reflect actual number of delinquent taxpayers since some taxpayers may have more than one outstanding account. For example, a separate account is established for each quarter an employer is delinquent in payment of withholding taxes. To address all these accounts, each collector would have to address approximately 4,000 accounts each month. During our review, we noted phone collectors can adequately address a maximum of 600 accounts per month. Legal collectors can reasonably address a maximum of 300 accounts a month. We found all collectors can adequately work 12 to 15 percent of their assigned accounts. Sixteen percent of the outstanding accounts are paid when delinquent notices are sent.

The large number of files or accounts assigned to staff effects the timeliness in which files or accounts are addressed. We found Compliance Section staff cannot consistently meet their deadlines. In reviewing 60 compliance files, we found 25 percent of the files were not worked in established time limits. This same problem occurs in the Accounts Receivable and Collection Section. This restricts the division's ability to meet its goal of addressing all accounts receivable before they are two years old.

In reviewing the cost effectiveness of current staff levels we determined Accounts Receivable and Collection Section staff have a significant rate of return for each dollar spent by the department. Phone collectors, who deal with newer accounts and have initial contact with taxpayers, collect approximately $41.00 for each dollar spent. Legal collectors deal with older accounts which are harder to collect and take more staff time to pursue. Their rate of return is $15.60 for each dollar spent. Due to the increase in receivables and workload, we believe department management should reevaluate staff levels in various sections of the Income and Miscellaneous Tax Division.

Division management has transferred one legal collector position to a phone collector position. Management is reviewing the present staffing to ensure they apply their resources to the greatest need in the most cost effective manner.

Recommendation #7

We recommend department management consider allocating its resources to areas of its operation which will result in the most benefit to the state.

Communication

During our review of the division we noted communication among the various sections and with employers and taxpayers could be improved.

Division Communication

Insufficient communication within the division has resulted in limited knowledge among the staff of what duties are performed in other sections or who to contact when there are questions. For example, some staff members in the Accounts Receivable and Collection Section were not aware the Compliance Section does a comparison of IRS tax information with state tax information. Several staff members were also unclear on duties performed in the Control and Processing Section. Field Audit Section staff in Billings indicated they do not know which person to talk to in each section when they have questions concerning a specific tax or collection information.

Clear lines of communication and knowledge of other sections' duties would help eliminate duplication of work between sections and assure questions or problems are cleared in a more timely manner. It would also improve staff morale. We believe establishing one contact person in each section would decrease inconsistency of information and also encourage section interaction.

Division management's response to our concern indicated they designated a contact person in each section to attend other section meetings for the purpose of improved inter-section communication.

Recommendation #8

We recommend division management establish lines of communication between sections and educate personnel in other sections on duties performed and available information.

Better Communication with Employers and Taxpayers Needed

During our review we noticed staff use many form letters. We found some of the letters are inappropriate for the situation. Division correspondence indicates some form letters confuse employers and taxpayers. One goal of the division for the biennium ending 1988-89 was to improve the division image with the business community. Although the objectives of the goal were to make information more accessible, we believe the current letters sent to the employers and taxpayers do not improve the image of the department or the division.

Our review of withholding tax waivers revealed the division sends letters to taxpayers which do not address the issue at hand. Nine of thirteen waiver files we reviewed contained letters with a standard paragraph concerning post marks. The letters state the employer should be aware of when the post office places the post mark on the envelope if the employer is going to send the form on the date the form is due. One of the nine files had a timely filing but the payment was late. Employers in two of the nine files claimed they sent the forms in on time. The forms in the remaining six files were seven days to four months late. One of the latter files showed the forms were submitted to the department in response to a letter sent two months after the date the forms were due. The standard post mark paragraph does not fit these situations.

In another file we found the person had paid the penalties and interest and then requested a waiver. The waiver was denied. The letter sent to the employer indicated there was no money

due for penalties and interest. The body of the letter contained a narrative stating the penalties and interest due indicated at the top of the letter had to be paid and a check should be made out to the State Treasurer.

Some of the letters are not very clearly written. One letter states an appeal of the denial of a refund can be made based on the procedure in section 15-2302, MCA. Upon a review of the state statutes we found the cite should be section 15-2-302, MCA. Also, few taxpayers would know how to appeal the denial of a refund since they would not have ready access to state statutes. The letter also states the refund is denied pursuant to section 15-30-149(3), MCA. There is no explanation in the letter of what is contained in that section.

We believe form letters used by the division should be reviewed for appropriateness and content.

In response to our concern division management indicated they have begun a systematic review of all form letters, model paragraphs, instructions, etc. They will complete a review of revised text for clarity and tone, and standard text for appropriateness to the situations. They plan to have this completed in early 1990.

Recommendation #9

We recommend division management review form letters sent to employers and taxpayers for clarity and content.

Chapter V
Management Controls

Comprehensive Job Descriptions and Performance Appraisals

During our review we found job descriptions and performance appraisals were not comprehensive. Both the job descriptions and performance appraisals of some staff did not include all duties performed. The following sections discuss our concerns and recommendations.

Job Descriptions Need Updating

Accurate, complete job descriptions provide staff with clear guidelines of requirements and expectations essential for adequate performance. Job descriptions also provide supervisors with a useful tool for evaluating staff. We found duties performed in the Accounts Receivable and Collection Section often did not match job descriptions used in 1989. For example, the section supervisor was not completing the accounts receivable or the administrative duties outlined in the job description. The Collection Technician was primarily dealing with bankruptcies instead of providing support services to the collectors, such as locating taxpayers. The Administrative Clerk was not providing any research for the collectors as described in the job description.

Inaccurate and outdated descriptions are in place because management has not completed a current review of the duties performed by staff. The new accounts receivable computer system application automated several previously manual duties and changed the workflow in some areas. The supervisor is currently in the process of re-writing job descriptions. Actual duties performed at all staff levels should be evaluated and identified during the process.

Lack of complete, current job descriptions resulted in poor staff morale, bottlenecks of workload, and staff not recognized for duties performed. The new computer system created new duties which were not assigned but were performed by various staff as needed. The division should compile job descriptions that reflect actual duties performed. With the changes in duties resulting from the implementation of the new computer system application, staff input would be beneficial.

Recommendation #10

We recommend division management evaluate current job duties and write job descriptions to reflect duties actually performed.

Relationship of Performance Appraisals to Job Duties

The current division administrator implemented a formal performance appraisal policy when he started his job. Section supervisors were instructed to establish criteria which they would use to appraise staff. In evaluating this criteria, we found staff are not evaluated on many functions they perform. Staff are appraised on quantity of work performed. Quality of the work completed is not among the criteria. For example, we found not all job duties were included on performance appraisals in the Accounts Receivable and Collection, and Compliance Sections. The criteria on the appraisals is used to evaluate staff on the number of accounts identified or collected.

The current system allows people to perform the appropriate number of tasks, but the quality of the work is not measured. If errors occur for assessments of taxes due, for example, there could be lost revenue to the state.

Performance appraisals should relate to the job duties as outlined in the job descriptions. Appraisals should consider the quality of the work performed, and not just the quantity.

Current division management indicated the past philosophy of Department of Revenue management has been that criteria on performance appraisals must be quantified. Items considered subjective could not be used in performance appraisals. This precluded considering the duties performed that could not be quantified. Also, the quality of the work performed by staff was not considered.

Recommendation #11

We recommend division management revise the performance appraisal system to take into consideration all aspects of a person's duties and the quality of the work performed.

Assessment of Training Needs Important

Division management does not formally assess the training needs of the staff in the majority of the sections. The department has a formal training needs policy, but the policy is not used in most of the division. Training needs are discussed during informal performance appraisals, but nothing from the discussion is formalized. We believe the training needs policy should be followed and discussions formalized.

Department policy indicates employees are to inform their supervisors of training needs. Also, section supervisors are directed to discuss individual training needs with employees at least annually. The division administrator is then forwarded a list of training needs for each individual. Division administrators are to ensure training needs for all division employees are identified, and the needs reported to the department's Office of Personnel and Training on an annual basis. Training funds are also to be made available within budgetary limitations.

Without a formal training assessment process, management cannot determine the needs of the employees and communicate those needs to the Department of Revenue's Office of Personnel and Training for enrollment in courses. We found many employees use microcomputer packages on a daily basis and have received no training in the use of the software. Employees have expressed a desire to enroll in courses to learn the software, but have not been assigned the training.

Upper management in the department has not supported enforcement of the policy due to budgetary constraints. They do not want to inform a person he/she can take the training, and then not be able to send the person to the training due to lack of funds. During the assessment, which could be tied into performance appraisals, the employee could be informed training is contingent upon availability of funds.

Division management's response to our interim audit communication indicated they would distribute a copy of the formal department policy and request the supervisors to adjust their practices to comply with the policy.

Recommendation #12

We recommend division management implement the current department policy for assessing training needs.

Summary

Our review of the Withholding Tax program showed the legislative intent is being met, and the withholding tax monies are collected and properly recorded to the correct employer's account. The issues noted in this chapter primarily deal with management controls. Our recommendations include:

-- improving the supervision of staff in the Accounts Receivable and Collection Section;

-- establishing division, bureau, and section goals and objectives;

-- allocating department staff to areas of its operations which results in the most benefit to the state;

-- improving communication within the division and with employers and taxpayers;

-- correlating position descriptions to actual duties performed; and

-- assessing training needs of the division staff.

Division management started implementing the above recommendations. We believe this action will cause operation of the Withholding Tax program to be more efficient and effective.

Agency Response

State of Montana

Stan Stephens, Governor

RECEIVED

MAR 30 1990

Montana Legislative Auditor

Department of Revenue

Denis Adams, Director

Room 455, Sam W. Mitchell Building

Helena, Montana 59620

March 27, 1990

Mr. Scott Seacat, Legislative Auditor
Office of the Legislative Auditor
State Capitol
Helena, MT 59620

Dear Scott:

Attached is the Department of Revenue response to the Performance Audit of the Withholding Tax Program.

As you will note in our response, the Department of Revenue has seen significant management changes both at the Director's level and the Division level in the past 24 months. Also within this same period, the Income and Miscellaneous Tax Division has functionally reorganized to administer certain miscellaneous business taxes, implemented material changes to tax processing computer systems for both withholding and income tax processing and implemented a sophisticated departmental Accounts Receivable system.

All of these accomplishments have been material changes and have contributed to the Division **not** keeping pace with many of the activities identified in your report recommendations. Maintaining current training records, operating with out of date position descriptions, using out of date correspondence, and the like were the consequences of attending to the priorities created by the above changes. We agree that each of these areas are important and have welcomed your comments and recommendations. As you will see, we have and will continue to respond affirmatively to all but one of your recommendations.

We appreciate the cooperation and courtesy afforded us by your staff during the audit. If you have any questions regarding our response, please contact me.

Sincerely,

Denis Adams

Denis Adams
Director

Director - (406) 444-2460 Legal Affairs - (406) 444-2852 Personnel/Training - (406) 444-2866

"An Equal Opportunity Employer"

Recommendation #1:

We recommend division management establish an assessment rate which is consistent between sections and which more accurately reflects the amount owed.

Agency Response:

Concur.

We agree that inequitable results may occur if two sections are using different approaches to estimating delinquent employer taxes. In response the Interim Audit Communication dated 11-24-89, the Division changed it's procedures immediately to require use of a standardized 4% rate. The new policy was put into place on December 6, 1989 and will be consistently applied absent documentation justifying use of a different rate .

Recommendation # 2:

We recommend the department:

A. *Seek legislative authority to allow write-offs of delinquent taxes that cannot be collected; or*

B. *Transfer all such accounts to the Bad Debts Unit, State Auditor's Office.*

Agency Response:

Concur.

The Division's existing policies regarding write-off establish stringent requirements to be met before an account is written off. Although we feel management controls are adequate, we agree the statutes do not provide the division authority to waive or write-off taxes. We request the support of the Legislative Audit Committee and the Legislative Auditor's Office in seeking legislative authority to implement this recommendation. The ability to write off uncollectible accounts is a business necessity saving burdening the Auditor's Office with worthless accounts and overstating the Department's Accounts Receivable balances.

The alternative of transferring these accounts to the Auditor's Office, is a remedy but is inefficient. Before the Division can transfer an account, the account must first be placed in a warrant status. These extra procedures are required to comply with our confidentiality laws. The additional effort is not justified by the probability of collection of these accounts.

Recommendation # 3.

We recommend the division management update the Administrative Rules to include criteria for accepting the various methods for payment of taxes, penalty, and interest.

Agency Response:

Do Not Concur.

The Division has written policies regarding acceptance of installment payments of delinquent liabilities. These policies establish reasonable and consistent management controls. While we agree Department practice and policies normally ought to be conformed to rule, in this instance we have practical reasons not to publicize this policy.

Just as write-offs are a business necessity, so too are partial payments. Our collectors will suggest payment plans on a case by case basis consistent with our written policies, only after they have exhausted conventional means to obtain payment in full. To publicize payments as an option will invite greater use and dramatically increase the work load in the Accounts Receivable / Collection Section. What would optimally be accounted for as a single transaction under present practice, may, with wider use of payments, be transformed into as many as 18 transactions to be tracked through the system. We are confident our written procedures will address the auditors' principal concern, i.e. "to ensure all taxpayers are treated uniformly."

Recommendation # 4:

We recommend division management establish a formal supervision and review process of staff activities at all levels in the Accounts Receivable and Collection Section.

Agency Response:

Concur.

This performance audit of the Accounts Receivable and Collection Section was the first performed in more than 12 years. Division management agrees with the report findings and recommendations.

In response we have reinstated performance appraisals, established goals and objectives, reprioritized work, updated position descriptions, policies and procedures, and reassigned resources. This section continues to receive priority attention of Department management.

The challenges faced by this section are substantial. In addition to reassigning available FTE from other areas, management has developed proposed legislation to supplement enforcement measures and will be requesting funding to add collection staff. Both of these measures, and the corrective steps referred to above, are expected to improve the Department's effectiveness in resolving a record level of Accounts Receivable.

Recommendation # 5:

We recommend division management:

A. Determine what management information is needed and available; and

B. Eliminate duplicate information.

Agency Response:

Concur.

In part, this issue arose as a transitional issue due to bringing a new Accounts Receivable System on-line in February of 1989. We have since determined the necessary management information and have developed a detailed Monthly Collections Activity Monitoring Report. This monthly report extracts statistical information directly from the Department Accounts Receivable System concerning status and activity of the many different account types. A sample copy of the report has been provided to the Legislative Auditor's Office.

Aside from individual collectors performance statistics, this is the principal management report utilized by the Department to track this important activity.

Recommendation # 6.

We recommend division management establish goals and objectives for the division, bureaus, and sections, and periodically review the goals and objectives to determine if they are being accomplished.

Agency Response:

Concur.

The goals and objectives the Division were operating under at the time of the Legislative Auditors' field work were in fact dated. They have since been

revised, distributed throughout the Division and will be regularly monitored for attainment.

Recommendation # 7:

We recommend the department management consider allocating its resources to areas of its operation which will result in the most benefit to the state.

Agency Response :

Concur.

This is an ongoing process made more challenging by budget constraints and unpredictable staff turnover. Where possible we have identified positions which can be transferred temporarily or permanently to areas of greater cost effectiveness. Actions recently completed or planned to address this recommendation include:

1. **Reclassification of a legal collector position to a phone collector position to expedite initial contact with the delinquent taxpayer;**

2. **Reclassification of a word processor position to an Administrative Clerk III to provide research support to collection staff;**

3. **Hire a temporary collector to assist in a major special project to clear the system of our oldest accounts, if funding is available; and**

4. **Proposing a budget modification to the Governor's Office to increase collection staffing.**

These measures along with restoring staff to authorized FTE levels are clearly expected to improve the Section's effectiveness.

Recommendation # 8 :

We recommend division management establish lines of communication between sections and educate personnel in other sections on duties performed and available information.

Agency Response :

Concur.

Regular staff meetings have been reinstated and considerable cross training has occurred. Representatives from all sections are invited to participate in section meetings and relay information back to their areas. As well, a standing agenda item of every regularly scheduled management meeting is a report from each section supervisor and bureau chief of significant developments and anticipated projects in their areas. Intra-division communications have improved significantly.

Recommendation # 9 :

We recommend division management review form letters sent to employers and taxpayers for clarity and content.

Agency response :

Concur.

Every form letter presently in use by the Division has been reviewed for clarity, grammar, and content. In addition to subjecting each letter to analysis by available business correspondence software, the division administrator also reviewed the revised letters. The report recommendation was timely given the advent of new systems capabilities and the outdated references contained in some of the letters.

Recommendation # 10 :

We recommend division management evaluate job duties and write job descriptions to reflect duties actually performed.

Agency Response :

Concur.

Division management is requiring every position announced for hiring be posted with a current position description. In addition, we have begun a systematic review of each section in the division for outdated position descriptions for the purpose of bringing then current. The process will be completed before July 1, 1990.

Recommendation # 11 :

We recommend division management revise the performance appraisal system to take into consideration all aspects of a person's duties and the quality of the work performed.

Agency Response :

Concur.

We have already uniformly reinstated the performances appraisal process. With that accomplished, our next task is to overcome an historical bias toward objectively quantifiable performance indicators. This bias was acquired during the original training and implementation of the statewide performance appraisal process wherein we were encouraged to avoid subjective measures.

The Legislative Auditor's Office has provided examples of how they have incorporated qualitative measures into their process. As our appraisal cycles are completed and new cycles begun, each supervisor involved in appraisals has been directed to develop and incorporate qualitative measures into the process.

Recommendation # 12

We recommend division management implement the current department policy for assessing training needs.

Agency Response :

Concur.

Division staff are working with the Office of Personnel and Training to improve the system of accounting for training which has been requested, received or denied. As well, the Director has issued a proposed revision to the Department Training Policy.

Regular assessment of training needs will again become part of the performance appraisal process. These measures will certainly improve awareness of training activities. They will not however, resolve ongoing budgetary constraints of meeting agency training needs.

Appendix

APPENDIX A

Office of the Legislative Auditor

INCOME TAX WITHHOLDING QUESTIONNAIRE

Questionnaires were mailed to 43 states, excluding Montana, which we thought had a withholding tax program. Forty-two states responded. The following pages contain the questionnaire and a summary of responses. Comments were requested on many of the questions. Written comments were numerous and varied and generally are not listed in this appendix. The letter M next to the response indicates how Montana's Department of Revenue would have responded to our questionnaire.

1. Does your state require employers to withhold employee's income tax throughout the year?

   Yes - 39 M No - 3

2. How often is the withheld income tax collected from employers?

   4 - Weekly
   5 M - Partial Monthly
   33 - Monthly
   Quarterly - 37 M
   Biannually - 3
   Annually - 14 M

3. In establishing withholding tables, what are your state's objectives regarding the number of taxpayers claiming refunds versus the number of taxpayers paying additional taxes?

   13 - Try approximate taxpayer liability
   6 M - Give more refunds
   9 - Other
   11 - No answer

4. What penalties or interest charges are applied to those withheld taxes paid late or not paid?

Interest Rate

Rate	# States
0.5-1.5%/mo	6
8-11%/yr	6 M
12-18%/yr	6 M
Over 18%/yr	1
Federal Rate	3
Other	6

(Continued on next page)

Penalties

Variable Rate	# States	Flat Rate	# States
0.5 to 25%/mo	15	$2.00	1
5 to 50%/yr	9	$5.00	1
		2%-5%/mo	3
		5%-10%/yr	7 M
		15%-20%/yr	3
		25%-50%/yr	4 M
		Graduated	3
		Other	4

5. Does your state allow:

a. Employers to make partial payment of:

Withheld income taxes?	Yes - 15 M	No - 22	NA - 2
Interest?	Yes - 15 M	No - 21	NA - 3
Penalties?	Yes - 17 M	No - 20	NA - 2

b. Amounts owed but not paid by employers to be written-off for:

Withheld income taxes?	Yes - 19 M	No - 17	NA - 3
Interest?	Yes - 21 M	No - 13	NA - 5
Penalties?	Yes - 24 M	No - 10	NA - 5

c. What is your state's criteria for abating or waiving:

Withheld Income Taxes

17 - Don't allow
3 - Reasonable cause shown
M - Request in writing, show cause
2 - Employer shows assessment was issued in error
7 - Other
10 - No answer

Interest

16 - Don't allow
4 - Reasonable cause
2 M - Request in writing, show cause
8 - Other
9 - No answer

(Continued on next page)

Penalties

2 - Don't allow
14 - Reasonable cause
2 M - Request in writing, show reasonable cause
2 - Employer shows assessment made in error
2 - Can if requested by taxpayer
17 - No answer

6. What methods of collection are used for employers not submitting withheld taxes or not paying penalties or interest?

   a. Telephone calls — Yes - 37 M No - 1 NA - 1

   b. Written notices — Yes - 38 M No - 0 NA - 1

   (How many are usually sent before additional action is taken?)
   One - 5 Two - 7 Three - 12 NA - 15

7. Do employers have to submit W-2 forms to your department for each employee at the end of the taxpayer's year?

   Yes - 38 M No - 1

8. If the above answer was YES:

   a. Do you compare the individual's W-2 form to the W-2 submitted by the employer?

      Yes - 14 No - 19 M Other - 2 NA - 3

   b. How do you do the comparison?

      Electronically - 3 Manually - 13 Other - 4

   c. Are W-2s filed electronically?

      Yes - 26 M No- 7 Other - 3

9. Do you do any computer matches on employers with any other state agencies, such as Unemployment Insurance, or Workers Compensation?

   Yes - 13 M No - 25 NA - 1

(Continued on next page)

If YES, what matches do you make?

4 M - With Unemployment Insurance
1 - With Workers Compensation
2 - With Unemployment Insurance and Workers Compensation
2 - With Unemployment Insurance and the IRS
1 - With Welfare, Employment and Training, Veteran's Service, Child Support
3 - No answer

10. Please include any additional comments: (such as recent improvements in your withholding system.)

5 - Will soon optically scan withholding returns

1 - Employers able to make bank deposits at same time make bank federal deposits

2 - Combining filing of withholding tax with other taxes on one form

1 - Required W-2 information from employers on magnetic tape if the corporation is required to submit this information to IRS on magnetic tape

1 - Lockbox system where checks are deposited, forms scanned, and tape is loaded directly to mainframe

1 - Legislation effective 1-1-90 requires filing on magnetic media for employers of 250 or more employees